

GEORGIAN MICROFINANCE STABILIZATION AND ENHANCEMENT ACTIVITY

# Microfinance Mapping Survey

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## Executive Summary

In September/October, 2003, questionnaires, surveys and focus groups were conducted in order to develop the GMSE project's Year 1 Work Plan. Findings and recommendation are organized by task.

### **Task 1: Promote the Establishment of Unambiguous Legal Status and Tax Treatment of Non-Bank MFIs.**

There is a lack of understanding among non-bank MFI managers regarding the legal regulations and their flaws. However, there *is* a general consensus that changes to existing laws would be preferable to an "MFI Law." As a first step, Chemonics' legal expert, Giorgi Otariidze, will author a diagnostic study of the legal environment in Georgia, with an emphasis on recommendations to changes in the laws. The draft should then be submitted to potential members of the Policy Coordinating Body for comment, and used as a platform for discussions with the group. A specialist will need to be utilized to assist with drafting amendments to existing legislation. Additionally, training should be provided to the Georgian National Bank (GNB) in prudential regulation of non-bank MFIs.

#### **An Illustration:**

Under Georgian law, organizations may not borrow from banks and "issue credits" off the borrowed funds. However, non-banks issue "loans" rather than "credits." It is, therefore, legal for non-banks to borrow from banks and re-lend the funds. However, tax authorities are sometimes confused by the difference between a loan and a credit and this must be addressed.

### **Task 2: Increase Operational and Financial Sustainability of MFIs.**

None of the non-bank MFIs interviewed had achieved consistent operational and financial sustainability. Managers identified several barriers to sustainability, including:

- Georgia's poor legal framework;
- Lack of capital;
- High operating costs;
- Client repayment problems;
- High taxes; and
- Lack of affordable MFI staff training.

### **Task 3: Develop Partnerships with Commercial Banks and Non-bank MFIs.**

Currently, Georgian non-bank MFIs are bank clients, but there are no real bank/non-bank partnerships. The primary barriers to this are the competitive threat that banks and non-bank MFIs represent to each other, and a lack of understanding regarding what linkage possibilities exist. Therefore, first steps should include training for both banks and non-bank MFIs in models of bank/non-bank linkages around the world, keeping in mind the competitive constraints both types of organizations face.

**Task 4: Increase MFI Institutional Stability.**

None of the non-bank MFIs surveyed had achieved stability according to the definitions provided in the GMSE proposal. Some of the non-bank MFIs may need consulting assistance (or funding) to set up integrated MIS systems. Other training/consulting needs identified include:

- Governance;
- Internal audit;
- Portfolio management and collections;
- Microfin; and
- General business (especially marketing, product development, management and customer service) and banking skills.

**Task 6: Develop a Public Information Program to Promote the Values and Practice of Microfinance.**

The information program will aim to improve understanding of MFI legislative issues among policy makers, supporting Task 1. However, to support policy reform it must also promote a positive image of microfinance to the general public. This impacts all seven Tasks. So while the program must be partially based on the findings of the legal diagnostic and Policy Coordinating Body, public attitude surveys will also be conducted to determine what “image” messages need to be communicated and how. In initial surveys, non-bank MFI managers felt that the following needed to be promoted:

- Microbusinesses benefit the whole community, and MFIs support them;
- MFIs support economic development and, therefore, the entire population of Georgia;
- Non-bank MFIs represent a successful combination of social and market forces; but
- Non-bank MFIs are not commercial banks and, therefore, should not be regulated as banks.

## Introduction

A mapping survey was conducted during the first month of Georgian Microenterprise Stabilization and Enhancement Activity (GMSE) operations, in September/October, 2003. The goal of the survey was to give direction to and develop a strategy for Year 1 of the implementation of the GMSE project, and aimed to assess the most urgent needs pertaining to the first six of GMSE's seven tasks:

- Task 1: Promote the Establishment of Unambiguous Legal Status and Tax Treatment of Non-Bank MFIs;
- Task 2: Increase Operational and Financial Sustainability of MFIs;
- Task 3: Develop Partnerships with Commercial Banks with Branch Networks and Non-bank MFIs to Provide Additional Financial Services to MFI Clients;
- Task 4: Increase MFI Institutional Stability;
- Task 5: Develop Baseline Indicators and Small and Microenterprise Financial/Market Information and Statistics; and
- Task 6: Develop a Public Information Program to Promote the Values and Practice of Microfinance.

The survey utilized questionnaires, interviews, and focus groups, as well as secondary research. The resulting report maps microfinance activities in Georgia, as well as basic indicators of microfinance institutional sustainability and stability. It also maps legislative policy positions of non-bank MFIs. Finally, training needs identified by non-bank MFIs and the Chemonics team were included in the report, as well as research into possible training partners.

The findings are presented in order of task. The GMSE project's seventh task, to design, launch and manage the Credit Innovation Grant Program (CIGP) was beyond the scope of this preliminary research.

### Definitions:

Credit unions, banks, foundations, unions, and LLCs are providing microfinance are all microfinance institutions (MFIs). However, in this paper, credit unions will be referred to specifically as "credit unions," commercial banks as "banks" and foundations and unions providing microfinance as "non-bank MFIs (NBMFIs)." When "MFI" is used alone, the term refers to all three types of organizations.

## The Policy Map

*Promote the establishment of unambiguous legal status and tax treatment of non-bank MFIs*

Much work has been accomplished and debate taken place regarding recommended changes to legislation affecting non-bank microfinance institutions (MFIs). However, consensus on the matter has not been (and likely never will be) reached. Working with Mr. Giorgi Otariidze, the project's MFI Legal Specialist, the positions of stakeholders (commercial banks, non-bank MFIs, and regulatory officials) were surveyed. Mr. Otariidze also initiated his own research into legislation affecting microfinance, which will be documented in his forthcoming diagnostic study of Georgia's current legal environment for microfinance activities.

### The Georgian National Bank

Meetings with the Deputy Head of the Non-banking, Non-depository Supervisory Department of the Georgian National Bank (GNB)<sup>1</sup> and US advisors within the GNB<sup>2</sup> indicate the GNB is increasingly interested in regulating foundations and unions providing microcredit. However, it is doubtful the National Bank has the capacity to do so at present. Their regulation of credit unions got off to a rocky start in 2003 when the GNB licensed nineteen insolvent organizations<sup>3</sup>.

If a regulatory regime by the GNB is introduced, the regulation must be tailored to the operational realities of non-bank MFIs, most preferably utilizing a tiered regulatory

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<sup>1</sup> Meeting between Giorgi Otariidze, Mark Rostal, and Nikoloz Chlaidze, Deputy Head of the Non-Banking, Non-depository Supervisory Department of the GNB. October 2, 2003.

<sup>2</sup> Satterfield. Sept. 30, 2003.

<sup>3</sup> Jorjikia. Oct. 2, 2003.

system. This will require training for GNB personnel, perhaps including study trips to the National Bank of Uganda, which also regulates MFIs, as well as a trip to the December, 2003 MFC conference in St. Petersburg. Fortunately, the GNB has already begun educating itself in the regulation of non-bank MFIs. Mzia Tepnadze, the head of the Non-banking, Non-depository Supervisory Department, received initial training in the issues surrounding MFI regulation at the 2003 MFC conference in Krakow.

## Legislative Concerns

A survey of microfinance practitioners and a review of past policy work in Georgia identified several key areas of concern:

### Lack of a clear tax and legal status for MFIs

- **Primary vs. Secondary Activity:** Foundations and unions are allowed to engage in economic activity (e.g. microfinance) only as a secondary activity. Typically, the charter of non-profits providing microfinance states that their primary activity is to help the poor and they do this through their secondary activity, microcredit. However, a tax inspector viewing a non-profit MFI's operations is likely to view lending as the primary activity, making the organization guilty of operating illegally.
- **Credits vs. Loans:** Under Georgian law, only banks may disburse "credits." Everyone else disburses "loans." However, there is no real difference between a credit and a loan\*... until a tax inspector decides the MFI is actually disbursing credits and is in violation of the law.

The credit vs. loan issue has caused confusion as to whether it's legal for foundations and unions to borrow from banks and re-lend the funds. According to the Law on Commercial Banking, no entity may borrow funds and then use them to "issue credit<sup>4</sup>." However, the key word here is "credit." Non-bank MFIs make loans. Lombard shops, for example, regularly take gold deposits from their clients and use them as collateral at commercial banks, borrowing off the gold deposits and then relending the funds to their own clients at a higher rate. It is legal for non-bank MFIs to borrow from banks and re-lend the funds. And it should be noted that several non-bank MFIs\* have bank loans outstanding.

#### **Plans for the Future:**

The Danish Refugee Council plans to begin lending up to \$100,000 for loan capital to MFIs in West Georgia, starting in November, 2003. This will be paired with technical assistance (see pg. 21).

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\* Credits are cash only. Loans, however, may be cash or physical property (e.g. cars, livestock, etc.).

<sup>4</sup> Lyman, Tim and Kate Lauer. 20.

\* Business Assistance Initiative, CHCA and Support for Development.

### Collateral

- Some non-bank MFIs take cash collateral, however, MFI managers are worried that this practice gives the appearance of taking deposits. Under the Civil Code and Law on Commercial Banking, only licensed banks may hold deposits. However, natural and juridical persons may take loan guarantees. It appears that as long as the cash guarantee is not called a “deposit” it is legal for a non-bank MFI to take it. However, the MFI must have a clear contractual arrangement with the client regarding management of the funds and the deposit should be held in a commercial bank.
- Foundations registering collateral are required to collect a letter from the Ministry of Justice every ten days stating that their foundation’s charter has not been changed. Banks get these documents from the courts on a monthly basis.
- Improve contract enforcement: MFIs win court cases (slowly), but once the case is won, they must use the Execution Bureau under the Ministry of Justice to enforce the decisions, and the bureau has few resources to seize and process collateral.
- Movable property registered at the Public Register is difficult to identify. According to the Georgian Civil Code, the Public Register may register both immovable and movable property. However, registered movable property registered through the Public Register is not well identified (no i.d. numbers, etc.), making it hard to track. This, however, is an issue that is outside the scope of the GMSE project. We will coordinate with USAID’s GEGI project in this area.
- Different kinds of movable property are registered by different agencies. Cars are registered at the police department. Local governments register agricultural equipment and livestock. Other items are registered at the Public Registry. Collateral should be registered by a single agency. This is another issue outside the scope of the GMSE, where we will coordinate with GEGI.

#### **Contract Solutions:**

BBK Financial Group has gotten around contract enforcement problems by inserting a clause in its promissory notes stating that disputes will be resolved through private arbitration. This enables them to get payment decisions in as little as two weeks. Clearly, NBMFIs have much to learn from each other.

### Taxes and Fees

- High taxes on micro traders force them into the grey economy, making the traders and the MFIs which serve them vulnerable. A new flat tax for sole owner/operators has been developed (Chapter 12<sup>1</sup> Article 207<sup>1</sup>), which could result in a substantial tax reduction for many microentrepreneurs\*. However,

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\* Flat taxes are naturally regressive and for the very poor, the flat tax would represent an increase over the regular schedule of income and social taxes. The self-employed must pay social taxes (employer + employee



few microtraders seem to be aware of this option, and they continue to flounder in the grey economy.

**The Grey Economy:**

Under the regular schedule of income and social taxes, approximately 50% of the profits of self-employed microtraders goes to taxes.

- Article 2 of the Law on Grants states that grants may not be used for entrepreneurial or political activities. The Ministry of Finance has interpreted this to mean that grant funds used for entrepreneurial activity (e.g. microcredit) are income, and are taxed as such. Organizations protected under the US-Georgia Bi-lateral agreement are protected from this tax. However, the bi-lateral agreement states that it applies to US organizations (e.g. MFIs registered as branches of American NGOs). The Ministry of Finance has argued that locally registered recipients of USAID grants are not protected from income tax under the agreement.
- Fees for a foundation to change its charter (e.g. for a new director or change of address) are based on the foundation's issued share capital. For MFIs, which have large portfolios, these fees become burdensome, especially when compared to the fees other legal forms of organizations pay. Unions pay a flat fee of 17 GEL to change their charter. Commercial enterprises may pay anywhere from 45 – 180 GEL. However, for an MFI with \$1M in assets (i.e. a moderately successful Georgian MFI), the fee is 2,655 GEL (approximately \$1,265), including VAT. An MFI with \$2M in assets would pay 3,915 GEL (approximately \$1864).
- Non-bank MFIs should be allowed to deduct reserve fund payments for bad debts for tax accounting purposes, as commercial banks do.

**Other**

- FINCA has indicated it would like to engage in limited deposit taking from its clients (not from the general public) in order to mobilize loan capital and provide a savings service to its clientele. Currently, only commercial banks may legally take and re-lend deposits. A tiered regulatory system enabling Tier 1 MFIs to mobilize client deposits, might give the GNB the comfort level necessary to legalize limited deposit taking. FINCA would be an excellent candidate for this treatment, due to its strict system of internal controls.
- Privacy laws enabling a credit bureau to operate are needed. This is also beyond the scope of the GMSE project, and GMSE will coordinate/liase with USAID's GEGI project regarding it.
- Removal of the interest rate ceiling: "Pursuant to Article 625 of the Georgian Civil Code (GCG), loan interest may be specified by the parties, **and**

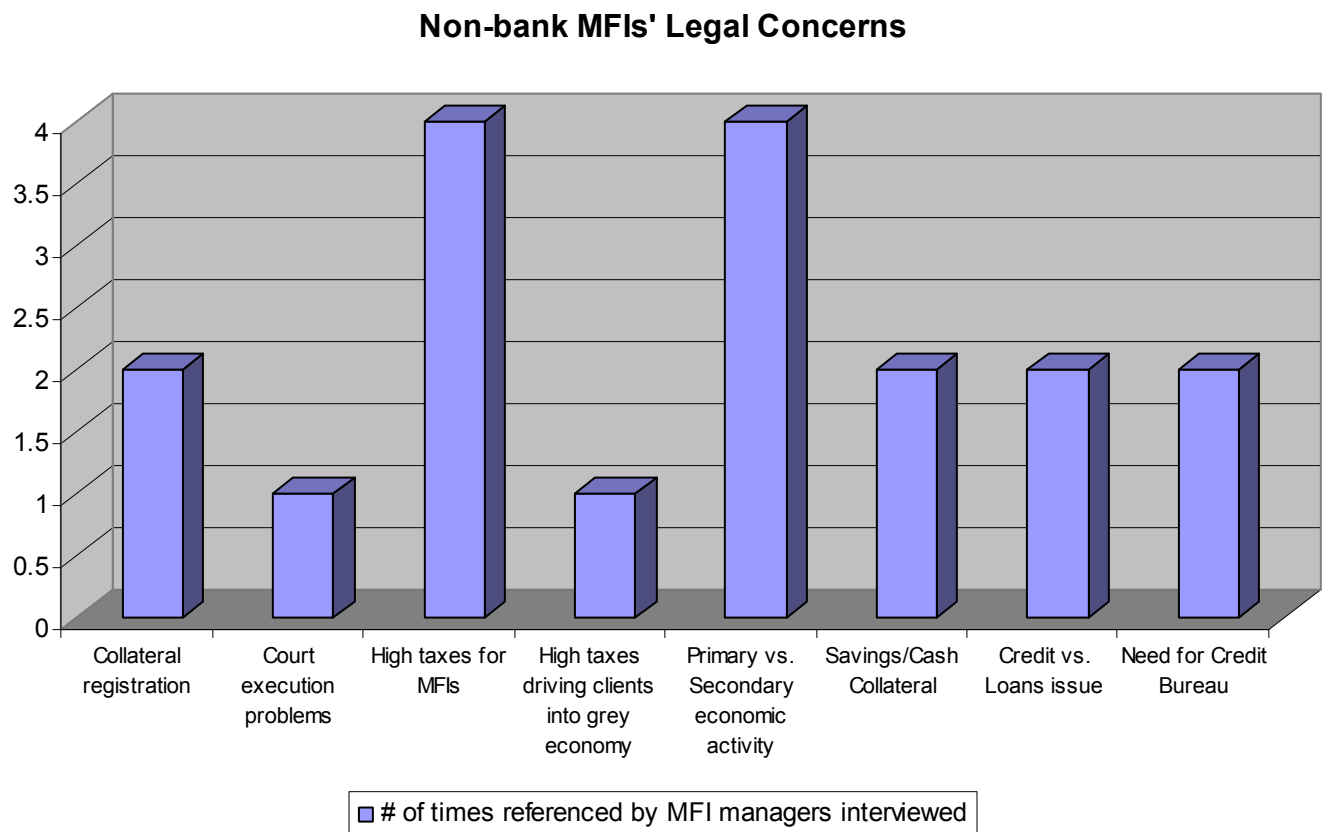
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contribution) totaling 33% on their gross profit (Art. 189.3) at the same time they pay their income tax, which is an additional 20% for individuals with an annual gross income over 600 GEL.

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shall be in reasonable conformity with the limits established by the National Bank, or by the interest rate of [the] interbank loan auction. An agreement made in violation of this rule is invalid.<sup>5</sup>” The interest rate charged by non-bank MFIs is typically far above that of the interbank loan auction, and to date the GNB has not set interest limits. The GCG should be changed so that loan interest may be based on market rates.

Figure 1: Microfinance Policy Position Chart of Foundations and Unions



## The Ministry of Finance

Since several of the suggested changes and issues listed above affect fees and taxation, work must also be done with the Ministry of Finance, which could be of assistance in lobbying for legislative changes. The Ministry is well regarded, and legislators tend to give it the same credence as they would the GNB. Therefore, the Minister and Deputy Minister should be invited to GMSE events and training activities.

<sup>5</sup> Otardze, 18.

The Ministry of Finance was recently divided so that the Tax Authority is now independent of it. It is recommended that the GMSE legal expert do some training for the Tax Authority on characteristics of non-bank MFIs, enabling them to better identify a legitimate non-bank MFI and understand its legal form of operations.

## The Way Forward

In 2002, Oxfam created a working group to draft a microfinance law (see Appendix A) and lobbied the Georgian government for its passage, most notably the State Chancellery and George Gongliashvili, Deputy Head of the President's Administrative Service for Economic Reforms and Relations with International Economic Organizations.<sup>6</sup> The working group, which included nearly all the Georgian non-bank MFIs, has since disbanded. However, the draft legislation it developed is so detailed in its definition of microfinance activities and how a non-bank MFI may operate, that it is unpalatable to Georgia's two largest microfinance organizations, FINCA and Constanta. For example, the draft law goes so far as to require that the MFI evaluate a borrower's credit rating using a three-grade rating system: 1, 2, 3. It would also restrict financial services activities to lending only, prohibiting any innovations in microinsurance, etc. (Please see Appendix B for a more detailed analysis of the draft law). Both FINCA and Constanta stated in interviews with Chemonics that they would prefer not to have a microfinance law per se, which would by its nature narrowly define microfinance activities and, therefore, be too limiting to their operations and to their ability to innovate. However, in spite of the objections of USAID, Constanta and FINCA, this draft law has made an impact in the Georgian government. "It's in their [Georgian legislators'] heads," said Tamara Lebanidze of Constanta. This draft law has created prejudices in the minds of some policy makers that the GMSE will need to overcome.

In an interview with Chemonics staff, Oxfam stated its intentions to continue lobbying for this law after the parliamentary elections in November, 2003<sup>7</sup>.

The author recommends that Chemonics develop a smaller, more focused MFI Policy Coordinating Body from members who qualify based on best practices criteria, rather than taking members wholesale from Oxfam's now defunct policy working group. Chemonics' legal specialist, Giorgi Otardidze, could begin the process by distributing a draft of his forthcoming diagnostic analysis of the current Georgian regulatory environment (with recommendations for changes) to potential policy group members for comment. Initial members of the Policy Coordinating Body could include:

- Chemonics (i.e. Giorgi Otardidze);

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<sup>6</sup> Getiashvili. Oct. 2, 2003.

<sup>7</sup> Getiashvili. Oct. 2, 2003.

- BAI;
- BBK Financial Group;
- CHCA;
- Constanta;
- FINCA;
- Oxfam; and
- World Vision.

Fortunately, all the NBMFIs interviewed expressed an interest in participating in such a policy coordinating body.

At later stages of the Policy Coordinating Body's meetings, a specialist (possibly from BankWorld) should be brought in to assist with the drafting of legislative amendments.

Chemonics' legal specialist also needs to coordinate with the ACDI/VOCA/SAVE and GEGI\* teams, as well as the IFC's "Leasing Development and Corporate Governance Project," regarding policy work they have or will conduct. To start with, the legal specialist must review the upcoming ACDI/VOCA/SAVE report assessing the policy, legal and regulatory constraints to agrobusiness, which may impact microlending to agricultural businesses. Additionally, the lawyers of these projects may be brought in as speakers or guests at certain Policy Coordinating Body meetings.

## Summary and Recommendations

A thorough study of existing laws affecting MFIs must be conducted to determine what needs to be changed. This study can be the platform for the future Policy Coordinating Body, by submitting it to potential members who qualify for comment. However, an initial assessment indicates that changes to existing laws would be preferable to creating a "microfinance law."

An analysis of what legislation needs to be changed can be done locally. In fact, it's preferable that it be done locally because no foreign experts will be able to understand Georgian legislation as well as a good Georgian lawyer. However, outside experts in the drafting of amendments to legislation will need to be consulted.

Additionally, the flat tax for sole owner/operators needs to be studied. Will it really represent a savings to microtraders? What is the level of awareness of this tax system?

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\* The GEGI project will be involved in credit bureau and collateral registration issues.

Can we work with MFIs to increase awareness, thereby bringing these traders out of the grey economy and improving public perceptions of microtraders themselves?

#### Top 10 Legislative Issues to Be Addressed

- Clarification of, or changes to the “primary/secondary activity” rule so that MFIs may engage in lending as a primary activity and remain non-profit entities;
- Clarification of credits vs. loans in the commercial code so that it is clear that MFIs are not banks and that they are lending (and re-lending commercial bank funds) legally;
- Change Article 2 of the Law on Grants so that grant funds may be used for entrepreneurial activity (i.e. microfinance);
- Removal of the interest rate ceiling;
- Improve collateral execution procedures;
- Change the way fees for changes to a foundation’s charter are applied so that they are in line with those of unions or commercial entities;
- Change rules for registration of collateral so that foundations need not take a letter from the Ministry of Justice every ten days – i.e. enable foundations to get the appropriate court papers monthly as banks do;
- Examine enabling qualifying non-bank MFIs to engage in limited deposit taking from their clients through a tiered regulatory system;
- Clarification of the laws regarding legality of non-bank MFIs to take cash collateral; and
- Change the tax law in order to enable MFIs to deduct reserve fund payments for bad debts as commercial banks do in their tax accounting.

Unfortunately, there is little chance of passing any law favorable to microfinance until key stakeholders such as the GNB, the Ministry of Finance, and other government officials understand what microfinance is, how microenterprise (i.e. small trade) benefits society, and what is reasonable prudential regulation for MFIs. This understanding should be developed through training and the planned public information campaign (see Task #6).

Finally, Chemonics’ legal specialist must coordinate and liaise with other organizations involved in policy and legislative reforms that may affect the microlending sector – e.g. ACDI/SAVE/VOCA, the GEGI project and the IFC’s “Leasing Development and Corporate Governance Project.”

## A Sustainability Map

### *Increase operational and financial sustainability of MFIs*

**S**ustainability is defined three ways in Section C of the GMSE Statement of Work: operational sustainability, financial sustainability, and stability. Chemonics' initial survey attempted to map non-bank MFIs' progress along all three axis. It should be noted that the below information was self-reported by the NBMFI, and has not been independently verified.

### Financial and Operational Sustainability

With the exception of BBK Financial Group, which is a for-profit LLC, no non-bank MFI surveyed was reported being financially sustainable, although several were close. Constanta, for example, was reaching occasional monthly financial sustainability. Half the MFIs surveyed had achieved operational sustainability.

	BBK	Constanta	FINCA	NorGe* *in the process of re-starting operations	GRDF (ACDI/VOCA)	SBDF (Oxfam)	World Vision	Assoc. Union of Trust	CHCA	BAI	Support For Development	SDA
Operational Sustainability	X	X	X	N/A				X		X	X	
Financial Sustainability	X											

When questioned about barriers to reaching sustainability, the responses of non-bank MFI managers were varied, including:

- Georgia's poor legal framework, both in terms of the non-bank MFI's legal status (primary vs. secondary activity) which puts them at risk of closure, and in terms of collateral registration and exchanging credit information, which restrict growth by constraining risks;
- Lack of capital;
- High operating costs;
- Client repayment problems;
- Microcredit providers concentrated in the same areas;
- High taxes and lack of clarity on what taxes are due; and
- Lack of affordable staff training.

A donor with goals parallel to the GMSE project's, the Danish Refugee Council, has also identified the need to increase the sustainability and stability among West Georgian MFIs. However, they have also expressed concerns that the GMSE project may push the MFIs they partner with away from serving the poorest of the poor<sup>8</sup>. MFIs frequently face a trade-off between sustainability and outreach to the very poor.

## Mapping Stability

According to Section C of the GMSE Statement of Work: "Institutions shall have in place an independent Board of Directors and governance policies in accord with international best practices; personnel management, succession and incentive policies; treasury management controls, an internal audit function which reports to the board and an annual external audit; a file server based, expandable, secure management information system including but not limited to loan tracking, general ledger, payroll and personnel and fixed asset modules able to serve multiple, geographically dispersed locations." This is the GMSE project's working definition of institutional stability.

Because of the limited time and scope of this initial research phase, the mapping survey focused on the below measures to gain an indication of MFI stability:

- The existence of an independent Board of Directors;
- The existence of incentive policies;
- The existence of an internal audit department;

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<sup>8</sup> Poulsen. Oct. 17, 2003.

- Whether the MFI undergoes annual external audits by an independent, international audit firm; and
- Whether the MFI is using a file server based, expandable, management information system integrating portfolio, payroll and accounting management functions, and able to serve multiple, geographically dispersed locations.

	Independent Board	Incentive Policies	Internal Audit Department	Annual External Audits	Expandable MIS, integrating portfolio management and accounting/payroll functions
BBK Financial Group					
Constanta		X	X	X	
FINCA		X	X	X	
Norge *In the process of re-starting operations	N/A	N/A	N/A	N/A	N/A
Georgian Rural Development Fund (ex ACDI/VOCA)					
Small Business Development Fund (Oxfam)		X		X	
World Vision		X			
Association Union of Trust					
CHCA		X	X	X	
Business Assistance Initiative (BAI)		X			
Support for Development					
Society Development Association (SDA)			X		



### Board of Directors

None the MFIs surveyed had a fully independent board (neither board of directors nor supervisory board) at the time of their interview with Chemonics. Several MFIs (notably World Vision and NorGe) were in the process of re-registering and reorganizing activities, and part of that process included developing a board of directors. How independent those boards will be, however, remains to be seen. Management representation on the board was typical of Georgian MFIs.

It should be noted that in Georgia there are usually two boards: a supervisory board elected by the company's founders/shareholders and a board of directors, approved by the supervisory board. Typically, members of a Georgian board of directors receive salaries, and are, therefore, not independent. The Law of Entrepreneurs (sections 55 and 56) defines both types of boards. Members of the supervisory board may receive portions of the company's profits rather than salaries.

### Audit

Most Georgian non-bank MFIs do not have internal audit departments, citing their extra cost and a lack of sustainability. Several of the international non-bank MFIs relied upon audits from their founder or international headquarters, rather than from independent audit firms.

#### **NB!**

The Danish Refugee Fund is currently involved in capacity building for local NGOs, and may make a good training partner for capacity building in West Georgia.

### Incentive Policies

Most of the non-bank MFIs surveyed had some form of incentive system for credit officers, typically based on a combination of portfolio quality, size, and number of clients.

### Software

None of the non-bank MFIs surveyed had an expandable MIS system with integrated portfolio management and accounting functions. Most were using a portfolio management database system, which they had developed internally (using Access, Excel or FoxPro, for example), in addition to separate accounting packages. The most common accounting/payroll management software used was Orisi, a locally developed package tailored to the Georgian tax and accounting system. FINCA and World Vision are both in the process of purchasing integrated software packages – a locally developed system for FINCA\* and the “Emerge” software package for World Vision.

## Summary and Recommendations

None of the MFIs surveyed were sustainable and stable. Please see Task Four, “Technical Assistance,” for detailed recommendations on how to increase MFI sustainability.

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\* FINCA plans to eventually replace its locally developed software with the SIEM system, by SoftCorps.

## Existing Bank/MFI Partnerships

*Develop partnerships between commercial banks with branch networks and non-bank MFIs to provide additional financial services to MFI clients.*

There were no true partnerships between the non-profit NBMFIs and banks interviewed. All the NBMFIs surveyed used the banks for cash holding and transfers – due to security concerns, the existence of a bank in a region is a prerequisite for an NBMFI's operations. In some instances, non-bank MFI loan disbursements and repayments take place at banks. Some NBMFIs\* have credit lines from commercial banks for loan capital. One non-bank MFI even used its bank's gold pawn department to appraise the gold used as collateral by its own clients. But NBMFIs have found that even these simple relationships can be fraught with competitive danger. In the case of one non-bank MFI whose clients were making their repayments directly to a commercial bank, the bank in question decided to go more “down market” in its lending, and used the NBMFI's client list as a starting point for its activities. Future bank/non-bank partnerships will need to be structured carefully, with competitive sensitivities in mind.

However, the GMSE team found one partnership between a commercial NBMFI, the BBK Financial Group, and the JSC Maritime Bank. BBK, which is based in Batumi, has taken an unusual approach to

### **Collision Course:**

*Banks are moving downmarket and NBMFIs upmarket. Why won't non-banks stick to their knitting?*

Non-bank MFIs in Georgia are turning to larger loan sizes (\$1k – 10k) for two primary reasons. The first is diversification. Georgia is a highly unstable environment, and MFIs need a diversified portfolio to manage their risk. The second reason is self-sustainability. After working with clients and helping them grow, non-banks are loathe to give up their income producing clients. When they're trying to become self-sustainable, why should they give up good clients?

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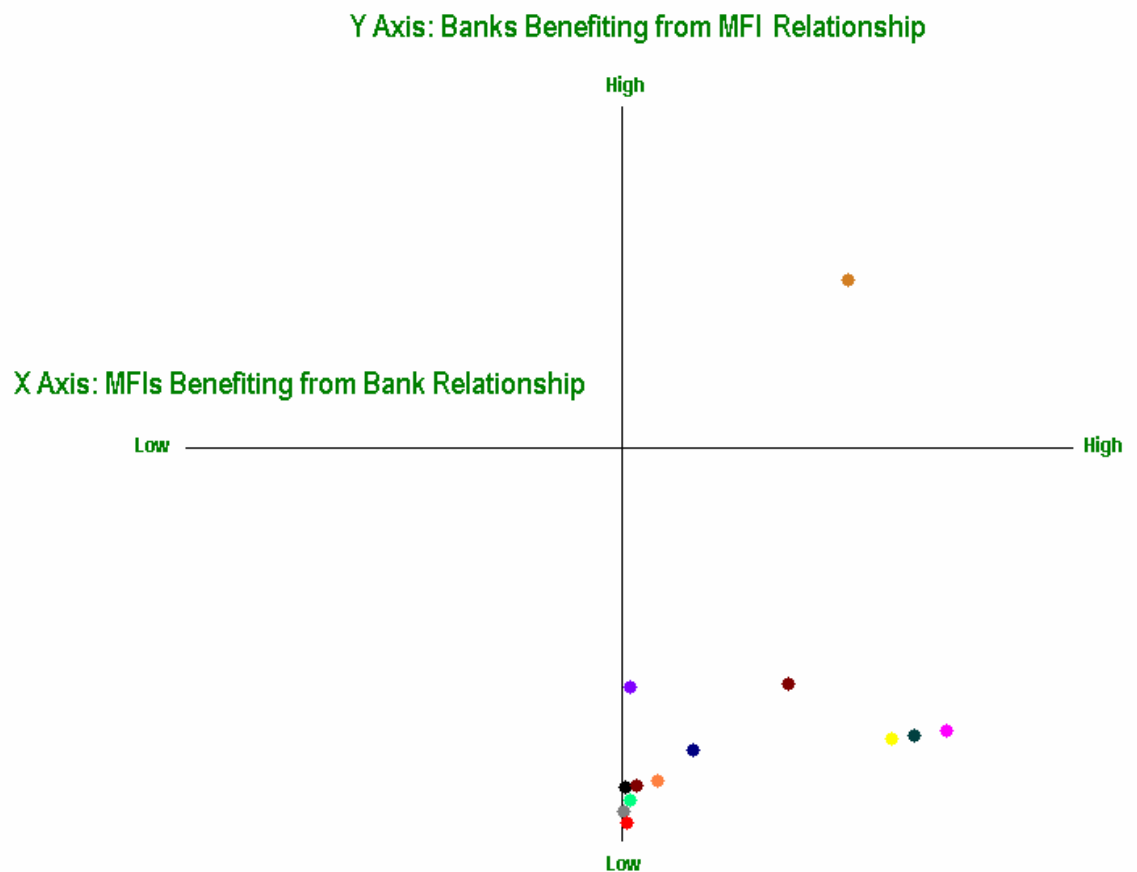
\* Business Assistance Initiative, CHCA and Support for Development.

microlending. The company utilizes promissory notes, drawing up a note with an average of 3-4% interest per month and “purchasing” it from the “borrower.” The company then sells the note to the bank. BBK has an account in the bank, and retains the risk for the note after sale.

Georgia’s non-profit NBMFIs remain clients of banks, rather than partners. As can be seen from the diagram below (Figure 1), few non-profit NBMFIs are fully utilizing bank services and opportunities, and aside from receipt of fees for services or interest income on loans extended to non-bank MFIs, banks have not been greatly benefiting from the relationships. Again, the sole exception is the partnership between the for-profit BBK Financial Group and the JSC Maritime Bank, which is represented in the upper right corner of the diagram.

The non-profit NBMFIs interviewed in West Georgia felt that banks had little understanding of the services and benefits they offered. While interested in working more closely with banks, the managers had little idea as to how. Opportunity exists to expand linkages between banks and non-banks.

Figure 2: Bank/MFI Partnership Continuum



## Barriers to Partnerships

There's good reason, however, why cooperation between banks and non-bank MFIs in Georgia has been limited. Georgian commercial banks and non-bank MFIs are competitors. Non-bank MFIs are becoming more commercially oriented and professionally operated, while commercial banks are moving into the microcredit market, narrowing the gap between the two and increasing competition. This trend is good news for the microcredit consumer, as it fuels product and delivery innovations and diversification. However, it makes partnerships between bank and non-bank MFIs problematic.

The success of partnerships between banks and non-banks MFIs will, therefore, depend on non-bank MFIs' ability to differentiate themselves from banks,<sup>9</sup> reducing the competitive threat. But even with such differentiation, non-bank MFIs have cause to be wary in basing their long-term strategies on close partnerships with commercial banks<sup>10</sup> as the latter move more deeply into the microfinance market. Georgian NBMFIs can and should, however, expand their use of banks' technical services<sup>11</sup>. A first step to facilitate this will need to include training that outlines different types of linkage opportunities, as well as facilitating information sharing between non-bank MFIs which have successful linkage relationships. And as a final warning, NBMFIs must take care not to share their client information too freely with commercial banks and to provide employee incentives in order to retain their best staff.<sup>12</sup>

## Model Linkages

In other countries, a range of bank/non-bank linkage possibilities have evolved. These include:

	Sample Linkage	Utilized by Georgian non-bank MFIs?	Constraints
1	Banks lending to non-bank MFIs;	Yes	Vague legality (see pg. 5)
2	Non-bank MFIs utilizing front or back office services of commercial banks;	Yes	None.
3	Banks and non-bank MFIs sharing facilities;	Yes	Competitive pressure/potential to "steal" clients.
4	Non-bank MFI clients gaining access to products/services of commercial banks;	No	Competitive pressure/potential

<sup>9</sup> Reinke, 13.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

	Sample Linkage	Utilized by Georgian non-bank MFIs?	Constraints
			to “steal” clients.
5	Banks buying non-bank MFI portfolio, or merging with non-bank MFI; and	No	None
6	NBMFIs acting as agents of banks/Banks contracting with non-bank MFIs to conduct operations <sup>13</sup> .	Yes (BBK and the Maritime Bank)	Lack of bank demand. Banks are frequently more efficient microcredit providers, and have strong regional infrastructures for lending.

The greatest opportunities for expansion of linkages involve the first two options – banks lending to non-banks and the utilization of commercial bank front and back office services by NBMFIs. A few Georgian MFIs are already exploiting these relationships, and others could learn from their successes.

Facility sharing – a simple and logical idea on the surface – is surprisingly fraught with difficulty in Georgia. Few Georgian banks have the facilities to handle the massive number of microclients which non-bank MFIs service – at least in the larger cities. And the MFI whose client list was “stolen” by its partner bank will likely be loath to enter into a similar “space sharing” relationship again.

The sixth linkage – utilizing non-banks as financial intermediaries – tends to provide transaction cost savings<sup>14</sup>. It has been used to great effect by the BBK Financial Group and the JSC Maritime Bank. This type of linkage is generally most successful in environments where banks do not have existing infrastructures in micro-markets and have little experience with microlending. However, the larger Georgian banks have infrastructures equal to or better than those of existing non-bank MFIs, with impressive coverage in regions outside Tbilisi\*. And commercial banks are quickly gaining experience in microlending. Therefore, the GMSE should facilitate a “lessons learned” session facilitated by BBK for other NBMFIs, and quickly. As competition between banks and NBMFIs increases, the window of opportunity for partnerships is closing.

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<sup>13</sup> Pearce 5.

<sup>14</sup> Seibel, 18.

\* The Bank of Georgia has 52 branches throughout the country. Although it is currently not disbursing microloans through all of them, it is poised to do so.

## Summary and Recommendations

Non-bank MFIs need banks for their cash operations, however, little real partnership activity has gone beyond that, partly due to ignorance as to the possibilities and benefits of linkages and partly due to the competitive threat banks and MFIs pose to each other. The latter threat is real, as banks discover that the market for large loans – particularly in the regions – is saturated and they begin to move “down market.”

“Potential for cooperation between banks and microfinance institutions dwindles and competitive pressures set in when banks start testing the microfinance market for themselves and microfinance institutions develop strategies for transforming into formal financial institutions.<sup>15</sup>” Any attempt at facilitating bank/non-bank partnerships must, therefore:

- Educate both types of organizations as to linkage benefits and possibilities;
- Facilitate information sharing between non-bank MFIs which currently have successful linkage relationships with commercial banks, particularly including the BBK Financial Group;
- Through training and technical assistance (see pg. 23), encourage product and target group differentiation between banks and non-bank MFIs in order to reduce the competitive threat; and
- Develop partnerships that emphasize technical linkages, rather than long-term cooperation.

In short, real partnerships may not be realistic in the Georgian environment. However, existing linkages can be improved and new linkages developed.

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<sup>15</sup> Reinke, 5.

## Technical Assistance

### *Increase MFI institutional stability*

*“The contractor shall promote institutional stability of MFIs by establishing capacity to train employees and potential employees of bank and non-bank MFIs in microfinance best practices... The contractor shall create training capacity in an existing institution that will provide training to Georgians (in the Georgian language) in microfinance best practices. The contractor shall assist the institution to develop trainers accredited in microfinance best practices. The institution should have adequate technology to teach financial tracking systems such as MICROFIN. It should also develop microfinance best practice materials, both in print and other media...” (C-3, Statement of Work).*

Alongside the GMSE grant program, training and consulting will be utilized to help MFIs reach institutional stability. To that end, a training needs assessment was conducted (see below). Potential training partners were also interviewed, and an overview of the findings can be found in the SWOT analysis at the end of this chapter.

## Training Needs Assessment

MFI managers were surveyed and interviewed as to their training needs and past training received. Internal training and the Microfinance Centre (MFC) in Poland were identified as the two main sources of skills training for MFI management and staff. However, non-bank MFIs, particularly in West Georgia, felt that the MFC was out of their financial reach and their own internal training was inadequate. The West Georgian MFIs also felt they were at a disadvantage to their Tbilisi-based competitors, who had greater access to training. For this reason, working with a training partner with offices in Tbilisi and Kutaisi could be advantageous. Finally, half the NBMFIs

interviewed requested greater information and lessons learned sharing between them. They clearly have much to learn from each other regarding bank partnership possibilities (and dangers) and legal issues.

The primary training needs identified by MFI managers and the Chemonics team were:

- Customer service;
- Marketing (including market research and product development);
- Product differentiation and positioning – how to compete in a narrowing market;
- General management skills;
- Commercial banking skills (e.g. portfolio management and ratio analysis);
- Microfinance specific skills (e.g. CGAP Best Practices);
- Governance;
- Internal Audit;
- How to get and manage a commercial bank loan; and
- Microfin.

MFI managers were primarily interested in general business skills training. However, the lack of internal audit departments and independent boards indicate that training in the benefits and workings of both are needed. And as banks and non-bank MFIs begin to compete in the micromarket, non-banks will need to differentiate themselves and their products – especially if successful linkages are to be developed (see Task 3). For this reason, training in product differentiation and positioning should be provided.

Some MFI managers expressed a lack of confidence in their ability to secure a commercial bank loan. Once the issues surrounding the legality of borrowing and re-lending are settled, training in securing a commercial loan would likely be welcomed.

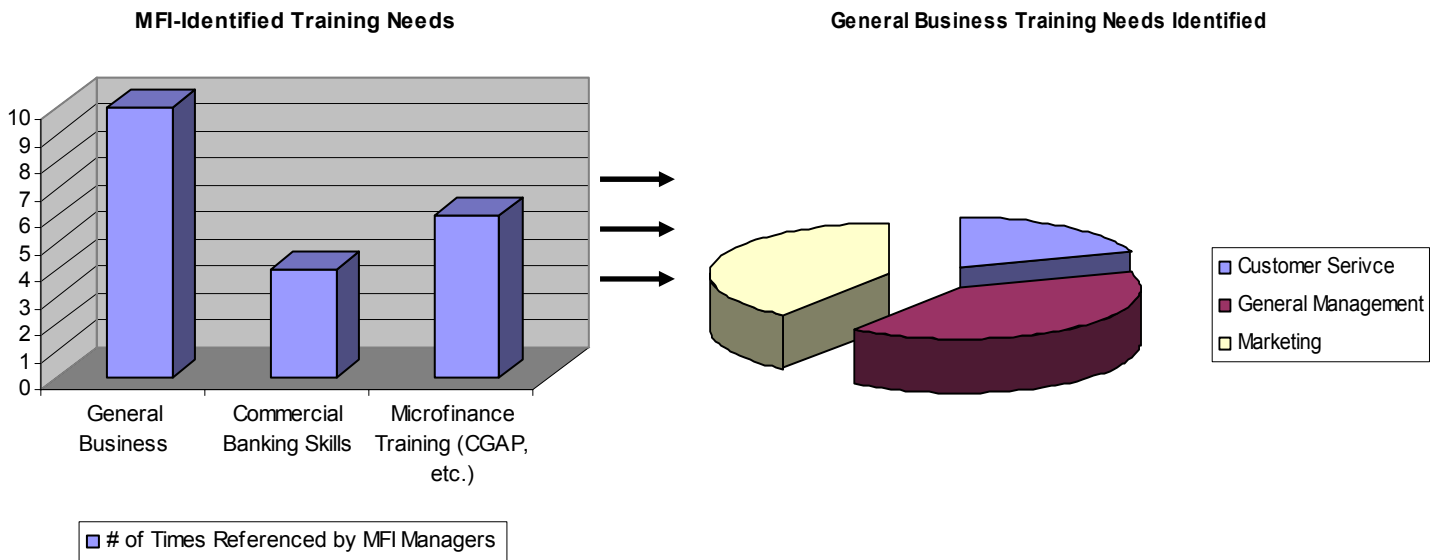
MFIs were not the only providers of microcredit interested in training. The Bank of Georgia requested consulting and technical assistance in new product development, with particular interest in agricultural lending as well as new products for SMEs.

The issue of Microfin training is complicated. There is a wide range in Microfin experience among Georgian MFIs. 70% of the non-bank MFIs surveyed use Microfin to some extent -- largely in response to donor demand. Several of the smaller MFI in



West Georgia, however, have not used Microfin at all. Therefore, consulting tailored to a particular MFI's needs (i.e. advanced vs. basic training) might be preferable to a group course which could only suit the needs of a few. The consultant may, however, wish to provide a "basic training" course to the West Georgian non-bank MFIs, utilizing a training facility in Kutaisi.

Figure 3: Training Needs Identified by Non-bank MFI Managers



## Potential Training Partners

The Georgian Microfinance sector does not have the critical mass to support a stand-alone microfinance training institution. Chemonics must, therefore, look to a training partner at or near sustainability, which is willing to add microfinance to its training calendar. It would be preferable to find an organization which already has experience in general business training (especially customer service and marketing), given the MFIs' self-identified need for it. Experience in bank training is also preferable, but not necessary. Computer facilities would be advantageous for Microfin training.

The Chemonics team interviewed four potential training partners in Tbilisi:

### **NB!**

The Danish Refugee Fund has a parallel goal to set up a training institution for MFIs. The planned center is to be based in Tbilisi. The GMSE team should coordinate with the DRC, as two training centers will not be sustainable.

- The Banking Finance Academy;
- CERMA;
- SMEDA; and
- The Center for Training & Consultancy (CTC).

CERMA had the most impressive training facilities and experience, with a roster of over 200 consultants, extensive business skills training and consulting experience, and its utilization of participatory training techniques. A SWOT analysis of the four organizations is below.

#### SWOT Analysis

	Banking- Finance Academy	CERMA www.cerma.ge	SMEDA www.kheta.ge/ company/smeda	CTC www.ctc.org.ge
Strengths	123a Agmashenebeli Ave. Tbilisi (32) 942605	42a Al. Kazbegi Ave. Tbilisi (32) 307701/05/06	80 Chavchavadze Ave., Tbilisi (32) 999077	30a Vazha Pshavela Ve. #7-8, Tbilisi (32) 25-19-82/75
	<ul style="list-style-type: none"> <li>▪ Strong reputation in banking community.</li> <li>▪ Extensive experience with bank training.</li> <li>▪ Strong relationship with USAID partners.</li> <li>▪ Multimedia capability.</li> <li>▪ Two classrooms.</li> <li>▪ Largest classroom seats up to 60 people.</li> <li>▪ Low prices attractive to MFIs.</li> </ul>	<ul style="list-style-type: none"> <li>▪ High quality, professional, physical facilities.</li> <li>▪ Utilizes participatory facilitation techniques and case studies.</li> <li>▪ Two classrooms plus a computer training room.</li> <li>▪ Training facilities in Tbilisi and Kutaisi.</li> <li>▪ Multimedia capability.</li> <li>▪ Roster of 200 consultants.</li> <li>▪ Training of trainers/consultants experience.</li> <li>▪ Experience training banks.</li> <li>▪ Has partnered with WB and other international organizations.</li> <li>▪ Consultants are required to regularly publish articles in local periodicals.</li> <li>▪ Sustainable, fee-based training (\$750 for a 72 hour course)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Experience with business training for banks and credit unions.</li> <li>▪ Roster of over 200 consultants.</li> <li>▪ Access to training facilities throughout Georgia.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Training of trainers/consultant experience.</li> <li>▪ Experience with governance training.</li> <li>▪ Moderate prices – 90 GEL/day + 45 GEL registration fee.</li> <li>▪ Multimedia capability.</li> </ul>
Weaknesses	<ul style="list-style-type: none"> <li>▪ Moderate physical facilities.</li> <li>▪ Fees may not be sustainable (\$70 for a 30 hour course, being increased to \$100).</li> <li>▪ No computer training facilities.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bank training experience minimal.</li> <li>▪ Priced higher than competition.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Low-grade physical facilities.</li> <li>▪ No multimedia capability.</li> <li>▪ Only one classroom, which holds 15.</li> <li>▪ No computer training rooms.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Low-grade physical facilities.</li> <li>▪ No computer training rooms.</li> <li>▪ Focus on “soft” NGO skills rather than business training.</li> </ul>

	Banking- Finance Academy	CERMA www.cerma.ge	SMEDA www.kheta.ge/ company/smeda	CTC www.ctc.org.ge
Opportunities	<ul style="list-style-type: none"> <li>▪ Linkages between MFIs and commercial banks?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Increased outreach to West Georgian FIs.</li> <li>▪ Computer software (e.g. Microfin) training capacity.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Increased outreach to regions.</li> </ul>	<ul style="list-style-type: none"> <li>▪ In 18-24 months they will have new, state of the art facilities.</li> </ul>
Threats			<ul style="list-style-type: none"> <li>▪ Image of facilities may reflect on project.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Image of facilities may reflect on project..</li> </ul>

## Summary and Recommendations

CERMA is the most professional of the four organizations listed above, and would make an excellent training partner because of the high caliber of its training facilities, its computer training capacity, and CERMA's experience in business training and consulting. Its training office in Kutaisi may also provide opportunities to increase the project's outreach in West Georgia.

The initial needs assessment suggests the most urgent training requirements are:

- Governance;
- Internal audit;
- General management skills;
- Marketing, particularly market research, product development, and customer service;
- Product differentiation and positioning;
- Commercial banking skills (i.e. ratio analysis, portfolio management, risk); and
- Microfin.

There is a wide range in the MFIs' familiarity with Microfin. A "basic training" class could be provided to MFIs with no experience using the product. More advanced technical assistance could be provided on a consulting basis, tailored to the needs of the MFIs with more experience using the program. To further encourage use of Microfin, all GMSE grant applications should require its usage.

The Bank of Georgia was also interested in technical assistance, particularly in new product development for microloan activities. As the EBRD is working with the Bank of Georgia, TbilUniversal Bank, and the United Georgian Bank to develop microcredit programs, Chemonics should coordinate training activities targeting these banks with the EBRD.

As indicated in prior Task chapters, the GMSE project must facilitate information sharing and lessons learned between NBMFIs. We recommend that the first session be led by the BBK Financial Group, which has done innovative loan contract and bank partnership work. BBK has agreed to lead such a session.

Finally, the GMSE project should coordinate with the Danish Refugee Fund, which is also planning to set up a training institution for MFIs. Two co-existing training centers for MFIs would not be sustainable in Georgia.

## Microfinance Activity Maps

*Develop baseline indicators and small and microenterprise financial/ market information and statistics.*

**M**icrofinance in Georgia is provided by three primary types of organizations: non-profit MFIs registered as unions or foundations, commercial banks, and credit unions. Of the three, unions and foundations serve the largest number of microclients (defined as clients with loans under \$10,000). As of August 31, 2003, it is estimated that in Georgia there were approximately\* 43,000 active microloan clients, served by the abovementioned providers. The clients of foundations and unions providing microfinance accounted for over 70% of this total, with the majority of their loans falling under \$1,000. However, when it comes to loans in the \$1,000 - \$10,000 range, commercial banks have the upper hand, with portfolios that dwarf those of the non-bank MFIs. As the market for large loans becomes saturated, Georgian banks are turning more seriously to microcredit. With their lower interest rates and more efficient operations, banks will pose a serious competitive threat to non-bank MFIs – particularly to those making loans over \$500.

There are several reasons why the client numbers of Georgian non-bank MFIs exceed those of commercial banks. First, the smaller the loan, the larger the market, and non-bank MFIs have excelled at penetrating the market for loans under \$1,000. Second, it has only been recently that commercial banks have begun experimenting with microcredit. Non-bank MFIs have a longer track record of microlending in Georgia. Third, there is still a deep-seated suspicion of Georgian banks among the general populace, particularly in the regions outside Tbilisi. However, as banks develop a history of providing microcredit, the non-bank advantage in this area will erode. The other competitive advantage of non-bank MFIs is their low (or no) collateral

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\* The number of credit union clients had to be estimated and only took into account licensed, solvent credit unions.

requirements, however, commercial banks have begun reducing their collateral requirements and ProCredit is piloting a micro product with no collateral requirements.

Credit Unions are the most problematic of the three types of microcredit providers, and they also have, on average, the least clients. The average licensed, solvent credit union in the Georgian World Bank-funded program has 115 members<sup>16</sup>. However, credit unions have been able to penetrate regions of Georgia untouched by banks, unions or foundations (see map, below) and tend to focus on agricultural lending, which few financial institutions have had success at. It is unclear, however, how successful credit unions have been either.

**Plans for the Future:**

The World Bank is initiating a new project, which will expand the number and scope of credit unions in Georgia. However, as of this writing, a definite budget and plan has not been drafted.

At the beginning of 2003, there were over 120 credit unions active in Georgia. However, a new law requiring the licensing of credit unions by the Georgian National Bank (GNB) has reduced the number of licensed credit unions to 42. Of these, nineteen are insolvent according to the World Bank<sup>17</sup>.

What has happened to the other credit unions?

According to the World Bank, most are bankrupt. However, the credit cooperatives funded by ACIDI/VOCA are attempting to re-register as foundations in order to avoid regulation by the GNB. It is unclear how many other credit unions will go this route, if any.

Finally, the BBK Financial Group deserves special notice. It is a commercial NBMFI, registered as an LLC, with an average “loan” size of 5,000 GEL (approx. \$2500). The BBK facilitates the creation of promissory notes from “borrowers,” then buys them from the clients and re-sells them to a local bank.

## Geographic Maps by Activity

The below activity maps only list locations where lending organizations are actively providing loans. So, for example, in cases where lenders have headquarters in Tbilisi but do not lend there, the lender will not be listed as active in Tbilisi. Lenders are listed alphabetically, as are the regions after Tbilisi. Only licensed credit unions considered “solvent” by the World Bank are included in the below maps.

Of the five banks disbursing microcredit, the Bank of Georgia is a special case. Its microcredit officers disburse microcredit to outlying towns from their main branches, however, these outlying towns are not mapped. Due to the difficulty in accurately mapping which loan officers are operating where, only the main branches have been listed on the maps and charts below. The Bank of Georgia anticipates that it will install

<sup>16</sup> Credit Union Development Center, 2002.

<sup>17</sup> Jorjikia. Oct. 2, 2003.

full-time microcredit officers in its sub-branches within the next twelve months, and these sub-branches will be included in future maps at that time.

Due to the transitory nature of Georgia's microfinance environment, all the maps and charts below should be updated every six months.

#### Credit Unions



#### Non-bank MFI Activities



Banks with Microlending Activities



All Microlending Activities





## Chart of Microlending Locations

### Tbilisi

	MFIs	Microlending Banks	Licensed Credit Unions
	Constanta	Bank of Georgia	Tbilisi
	FINCA	ProCredit	
	Society Development Association	TBC	
	World Vision	TbilUniversal	
		United Georgian Bank	

### Adjara

	MFIs	Microlending Banks	Licensed Credit Unions
Batumi	Constanta	Bank of Georgia	Peria
	World Vision	ProCredit Bank	
	BBK Financial Group		
Khelvachauri			Mejonistskali
Khulo			Agara
			Khulo
Kobuleti	Constanta	ProCredit Bank	Khutsubani
	Support for Development		
Poti	CHCA	Bank of Georgia	
	Constanta	ProCredit Bank	
	Support for Development		

### Guria

	MFIs	Microlending Banks	Licensed Credit Unions
Ozurgeti	CHCA		Meria
	Support for Development		

### Imereti

	MFIs	Microlending Banks	Licensed Credit Unions
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GMSE MAPPING SURVEY

Bagdati	Business Assistance Initiative		
Chiatura	Constanta		
Khoni	Business Assistance Initiative		Matkhoji
Kutaisi	Business Assistance Initiative CHCA Society Development Association World Vision	Bank of Georgia ProCredit Bank TBC United Georgian Bank	Amtkeli Lindava
Samtredia	Business Assistance Initiative		
Terjola			Chognari
Tskaltubo	Business Assistance Initiative		Tskhumi
Vani	Business Assistance Initiative		
Zestaphoni	Business Assistance Initiative Constanta Georgian Rural Development Fund (ex-ACDI/VOCA)*	ProCredit Bank	Kvaliti Meore Sviri

Kakheti

	MFIs	Microfunding Banks	Licensed Credit Unions
Akhmeta	FINCA		
Dedoplistkaro	Constanta FINCA		Arboshiki
Gurjaani	FINCA	Bank of Georgia	Gurjaani #2
Kvareli	FINCA		
Lagodekhi	Constanta FINCA		
Sagarejo	Constanta		

\* For the purposes of this map, the Georgian Rural Development Fund is being listed as an MFI, even though as of this writing, it was in the process of converting from a rural cooperative (i.e. credit union) to a foundation.

GMSE MAPPING SURVEY

Telavi	FINCA  Georgian Rural Development Fund (ex-ACDI/VOCA)		Kondoli
Tsnori	Constanta  FINCA  Georgian Rural Development Fund (ex-ACDI/VOCA)		

Kartli

	MFIs	Microlending Banks	Licensed Credit Unions
Gori	Constanta  Georgian Rural Development Fund (ex-ACDI/VOCA)  NorGe	Bank of Georgia  ProCredit Bank  United Georgian Bank	Tamarasheni
Khachuri	Constanta		

Kvemo Kartli

	MFIs	Microlending Banks	Licensed Credit Unions
Bolnisi		TbilUniversal	Tandzia
Gardabani	FINCA		
Marneuli	Constanta  FINCA	ProCredit Bank	
Rustavi	Constanta  FINCA  Society Development Association	Bank of Georgia  TBC	Mizdi
Sadakhlo	FINCA	ProCredit Bank	

Racha

	MFIs	Microlending Banks	Licensed Credit Unions
Oni			Pipileti

## Samegrelo

	MFIs	MicroLending Banks	Licensed Credit Unions
Martvili	Business Assistance Initiative		
Senaki	Association of Union Trust Society Development Association		Teklai
Zugdidi	Association of Union Trust CHCA Small Business Development Foundation (Oxfam) Support for Development	ProCredit Bank	Orsantia

## Samskhe-Javakheti

	MFIs	MicroLending Banks	Licensed Credit Unions
Akhalsikhe	Constanta World Vision	United Georgian Bank	
Akhalkalaki			
Aspindza Alexandre Khosrevandize			Mertshali
Bakuriani	Constanta		
Borjomi	Constanta World Vision	TBC	

## MicroCredit Activity Chart

	Agricultural Loans	MicroTrade	SMEs	Leasing
Bank of Georgia		X	X	
ProCredit Bank	X	X	X	
TBC			X	
TbilUniversal Bank		X	X	***
United Georgian Bank			X	

	Agricultural Loans	MicroTrade	SMEs	Leasing
Association of Union Trusts		X		
Business Assistance Initiative	X	X		
BBK Financial Group		X	X	
CHCA	X	X	X	
Constanta		X	X	
FINCA		X	X	
Georgian Rural Development Fund	X			
NorGe		X		
Small Business Development Foundation	X	X		
Society Development Association		X		
Support for Development		X		
World Vision	X	X		
Credit Unions	X			

**Plans for the Future:**

The Bank of Georgia has 52 offices in Georgia and plans to expand its microcredit activities throughout. It is particularly focused on the Baku-Ceyhan pipeline route, where it has existing client relationships due to its involvement in land acquisition for BP. Microcredit officers are currently based in their seven branch offices, but serve outlying regions such as Zugdidi as well.

While credit for microtraders and SMEs is fairly straightforward, two types of lending are of particular interest: leasing and agricultural lending. Both leasing and agro-loans have been problematic in Georgia, though for different reasons. Leasing has been hampered in Georgia primarily by unfavorable tax treatment, though since the development of a leasing law in May, 2002, two leasing companies were formed. TbilUniversal Bank established its “Georgian Leasing Company” in 2001 and as of this writing, has four clients and an outstanding portfolio of \$140,000, with lease loans averaging \$30,000 - \$40,000. A second “Georgian Leasing Company” was started up in 2003 by a rival firm, and TbilUniversal is currently in negotiations with the competitor to change its name.<sup>18</sup> USAID’s

<sup>18</sup> Gvalia. Oct. 1, 2003.

ACDI/VOCA/SAVE project also plans to develop a leasing company, and the GMSE team will continue to liaise with them on this. The IFC has also begun a “Leasing Development and Corporate Governance Project,” the aims of which include improving the regulatory environment for leasing. Although the size of Georgian lease loans currently falls outside the range of “microfinance,” these first steps bear noting, as leasing “particularly suits new, small or medium-sized enterprises (SMEs) without historical financial statements.<sup>19</sup>” In a 1998 report, the IFC estimated Georgia’s leasing market at around \$20 million (ibid).

Georgian agricultural lending has been plagued by defaults and arrears. However, because of the agricultural sector’s importance in the Georgian economy interest remains in developing lending products targeting it. Agro-business is also of critical importance to Georgia’s working poor. In Samskhe Javakheti, for example, subsistence agriculture employs the majority of the population<sup>20</sup>.

How serious are lenders about agro-business? The Bank of Georgia has expressed a desire to develop an agricultural loan product<sup>21</sup>. Microlenders such as World Vision and ProCredit Bank (which, as of this writing, is piloting an agricultural loan program in Marneuli, Gori, Batumi and Kobuleti) have new agricultural products that attempt to minimize risk by requiring that their borrowers have diversified income sources. It should also be noted that credit unions remain primarily agricultural lenders. The World Bank encourages the credit unions that fall under its purview to limit their loan sizes to 500 GEL (approximately \$250), keeping them firmly within the “micro” range.

## NBMFI Profiles

Profile data is as of August 31, 2003.

### Association of Union Trusts

Location of Headquarters	84 Agmashenebeli St., Zugdidi
Telephone of HQ	(995 21) 55-00-71; (995 99) 11-99-19
Operating In:	Zugdidi and Senaki
Types of Lending:	Group and Individual lending
# of Clients	1892

<sup>19</sup> IFC, 1 – 14.

<sup>20</sup> International Organization for Migration, 17

<sup>21</sup> Panjakidze. October 10, 2003.

% Female Clients	66%
Outstanding Portfolio in GEL	714,316

## Business Assistance Initiative

Location of Headquarters	44 Tamar Mefe, Kutaisi
Telephone of HQ	(8-231)-40-01-16; (899) 90-94-30
Operating In:	Kutaisi, Khoni, Samtredia, Bagdati, Tskaltubo, Zestaphoni, Vani, Martvili
Types of Lending:	Individual and group solidarity loans up to 1600 GEL
# of Clients	428
% Female Clients	55%
Outstanding Portfolio in GEL	728,880

## BBK Financial Group

Location of Headquarters	17 Gamsakhurdia st., Batumi
Telephone of HQ	General director Davit Badzgaradze: (99) 23-62-26; Shota Charxalashili, manger: (99) 50-20-67; Office: (8-222) 75-109, 75-794.
Operating In:	Batumi
Types of Lending:	Individual business and consumer lending via promissory notes up to 40,000 GEL. Average loan size is 5,000 GEL. Business "loans" target SMEs and microtraders. BBK is registered as an LLC.
# of Clients	416
% Female Clients	46%
Outstanding Portfolio in GEL	883,404

## CHCA

Location of Headquarters	29 Tabidze St., Kutaisi. 4600
Telephone of HQ	(995 33) 14-16-51/52/53; (877) 46-28-65
Operating In:	Kutaisi, Zugdidi, Poti, Ozurgeti
Types of Lending:	Individual and group loans up to 3,000 GEL targeting microentrepreneurs and a credit line for SMEs up to \$10,000
# of Clients	1,119
% Female Clients	72%
Outstanding Portfolio in GEL	901,289

## Constanta

Location of Headquarters	115 Tsinandzgvishvili, Tbilisi
Telephone of HQ	(995 32) 95-30-20
Operating In:	Tbilisi, Batumi, Gori, Zestaphoni, Akhaltiskhe, Rustavi, Tsnori, Chashuri, Marneuli, Dedoplistkaro, Lagodekhi, Sagarejo, Kobuleti, Poti, Borjomi, Bakuriani, Chiachura.
Types of Lending:	Group solidarity and individual (collateralized)
# of Clients	17,200
% Female Clients	71%
Outstanding Portfolio in GEL	6,000,000



## FINCA

Location of Headquarters	9 Vachnadze St., Tbilisi
Telephone of HQ	(995 32) 25-08-85, 25-34-97, 25-36-88/89
Operating In:	Rustavi, Gardabani, Marneuli, Sadakhlo, Bolnisi, Telavi, Kvareli, Akhmeta, Gurjaani, Tsnori, Dedoplistkaro, Lagodekhi.
Types of Lending:	Group solidarity and individual (collateralized)
# of Clients	7,013
% Female Clients	68%
Outstanding Portfolio in GEL	3,360,000 (approx).

## Georgian Rural Development Fund (ex ACDI/VOCA)

Location of Headquarters	9 Arakashvili, 2 <sup>nd</sup> Floor, Tbilisi
Telephone of HQ	(899) 55-09-90
Operating In:	Gori, Tsnori, Telavi, Zestaphoni
Types of Lending:	Collateralized agricultural loans to individuals
# of Clients	1,755
% Female Clients	4%
Outstanding Portfolio in GEL	5,250,000 (approx)

## NorGe

Location of Headquarters	19a Tabukashvili St., Tbilisi
Telephone of HQ	(995 32) 92-31-62, 92-31-64
Operating In:	Gori
Types of Lending:	Individual, collateralized loans
# of Clients	0 (Currently re-structuring operations – re-start up planned for November.
% Female Clients	N/A
Outstanding Portfolio in GEL	N/A

## Small Business Development Fund (Oxfam)

Location of Headquarters	Apt. 1, 47a Paliashvili St., Tbilisi
Telephone of HQ	(995 32) 25-28-81/83
Operating In:	Zugdidi
Types of Lending:	Solidarity group loans targeting microtraders and agricultural producers with more than one income source.
# of Clients	500
% Female Clients	50%
Outstanding Portfolio in GEL	600,000 (approx)

## Society Development Association

Location of Headquarters	6 Sagaradze, Kutaisi
Telephone of HQ	(899) 91 23 43, 41-65-2
Operating In:	Tbilisi, Rustavi, Kutaisi, Senaki
Types of Lending:	Individual and group solidarity microloans, ranging from 300 – 4000 GEL. Targets IDPs
# of Clients	483
% Female Clients	58%
Outstanding Portfolio in GEL	500,000

## Support for Development

Location of Headquarters	4 Tavisufleba Square 4th Floor, Kutaisi
Telephone of HQ	(822) 99-55-07
Operating In:	Zugdidi, Kobuleti, Poti, Guria Region
Types of Lending:	Individual lending
# of Clients	537
% Female Clients	55%
Outstanding Portfolio in GEL	615,123

## World Vision

Location of Headquarters	1 Leonidze St., Tbilisi
Telephone of HQ	(995 32) 99-83-84, 93-29-76
Operating In:	Kutaisi, Batumi, Borjomi, Akhaltiskhe and Tbilisi
Types of Lending:	Individual lending for agricultural businesses and group lending for microtraders.
# of Clients	1,650
% Female Clients	67%
Outstanding Portfolio in GEL	1,554,000 (approx)

Total reported outstanding portfolio for non-bank MFIs surveyed: 21,107,012 GEL (approx.)

## Summary and Recommendations

The microcredit sector in Georgia is undergoing dynamic change. The commercial banking sector's increasing interest in microcredit may dramatically alter the shape of Georgia's microfinance industry. Microfinance activities have spread well beyond Tbilisi, and though gaps in the provision of credit remain they are being filled. The World Bank is developing a program to expand the reach of credit unions in Georgia. And both bank and non-bank MFIs are planning new locations throughout the country, most notably in Samskhe-Javakheti, a region of increasing strategic importance\*.

The growth of the sector is receiving a further boost as new types of microfinance products are also being piloted. From agricultural credit to insurance, MFIs are seeking out new innovations to grow and diversify their portfolios.

Therefore, due to the fluctuating and volatile nature of Georgia's microcredit sector, the mapping information contained in this chapter should be updated every six months.

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\* Because certain plans for future locations and new loan products are competitively sensitive, non-public information has been excluded from this report.

## Public Information Campaign

*Develop a public information program to promote the values and practice of sustainable microfinance.*

Although the public information campaign is cross-cutting, affecting all other GMSE tasks, the legal and regulatory component of the GMSE project dictates that the campaign must aim to affect the attitudes of policy makers, as well as the general public. The following chapter reviews the GMSE's primary target audiences for such a campaign. It also chronicles the opinions of MFI managers, who were interviewed as to what were the most important media messages for policy makers and the general public.

### Who is our target audience?

The focus of the GMSE public information campaign is to support Task #1, the promotion of “unambiguous legal status and tax treatment of non-bank MFIs. The information program shall be targeted to officials, parliamentarians, academics, opinion leaders and selected publics.” In addition to the general public, the aforementioned officials should include the GNB and the Ministry of Finance. The former is considering regulating MFIs and the latter is responsible for tax collection and enforcement.

### What do they need to know?

A detailed opinion/attitude study of the above target audiences will be conducted in month three of the GMSE project. However, non-bank MFI managers surveyed felt that policy makers had little understanding of what MFIs were, and held a negative

attitude towards MFI clients. Prior public information campaigns and the marketing efforts of MFIs themselves have led to an increased, positive perception of MFIs among the general public. However, the negative attitudes toward MFI clients may linger. “In the Spring of 2001, articles in the Georgian media appeared complaining about the abundance of this informal trade. These articles argued that micro-traders avoid their fair share of the tax burden and constitute a public nuisance<sup>22</sup>.” If this attitude remains prevalent, then it will be difficult to promote positive legislative and policy changes affecting MFIs.

Therefore, the public information campaign must do two things – first promote the benefits of MFIs and the clients they serve, and then advocate for specific changes to the legislative/policy environment. The latter will be based on Mr. Otardze’s diagnostic report on Georgian legislation affecting microfinance, as well as work conducted by the Policy Coordinating Body.

## What do MFIs want to say?

When queried in interviews and focus groups on what participants felt the public should know about microfinance, one manager summed up: “MFIs have a banker’s mind and a humanitarian soul<sup>23</sup>.” Specifically, they felt it was important for the public and for governmental decision makers to understand that:

- Small and microbusinesses benefit the whole community, and MFIs support these businesses;
- Microfinance supports economic development and the population of Georgia;
- Microfinance provides a social benefit;
- Although MFIs are socially oriented, clients are required to repay loans at a market interest rate – MFIs represent a successful combination of social and market forces;
- MFIs are not banks (and should not be regulated as such);
- MFIs are helping to create a positive repayment culture in Georgia, and this benefits the financial community as a whole; and
- MFIs have not created the grey market – it has been created by inappropriate tax and social policies and those need to be corrected.

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<sup>22</sup> Otardze, Giorgi. Alice Weiss, Kirsten Weiss. 5.

<sup>23</sup> Dzadzua. October 8, 2003.

Although microfinance is becoming increasingly well-known, a negative perception of microtraders remains. As long as microtraders are perceived as a social evil rather than the first steps in Georgia's fledgling market economy, it will be difficult to pass enabling legislation for the MFIs which serve them.

However, some MFIs interviewed were understandably less concerned about promoting sustainable microfinance than with marketing their services to potential clients. The media messages they wanted to target this audience with included:

- The high interest rates of MFIs represent a trade-off for their flexible collateral requirements.
- MFIs are not places to turn to if a business is not “good enough” for a bank loan.
- Microfinance is a service to help entrepreneurs grow and develop their business.

Interestingly, there is a gap between the marketing message MFIs want their clients to have and the marketing conducted by MFIs. Every MFI interviewed primarily relied upon word of mouth for its marketing. Word of mouth is, of course, a highly effective means of advertising. However, it is not a good medium for getting the above messages across.

## How do we proceed?

Further research needs to be conducted into the attitudes of GMSE's target audiences regarding MFIs and microentrepreneurs. Based upon the results, the GMSE team may develop the first phase of its information campaign, targeting the general public and promoting a positive image of MFIs and their clients. The second phase of the information campaign – advocating for legislative change – will be dependent on the findings of Chemonics' legal team and the MFI Policy Coordinating body. Once consensus has been reached on needed amendments to legislation affecting non-bank MFIs, this phase of the public information campaign will work in concert with GMSE's legislative team to promote these changes.

Since the public information campaign is so closely associated with Task #1, it is recommended that once the MFI Policy Coordinating body has reached consensus on the legislative issues to be addressed, members of the coordinating body should be trained in the development of media messages and in dealing with the press. They then may assist the GMSE team in the creation and delivery of the decided upon messages – at microfinance training for members of the press, in interviews, etc.. Although Chemonics will be implementing a formal public information program, it is important that the non-bank MFIs affected speak with a unified voice in this regard.

## Summary and Recommendations

The public information campaign may be broken into two primary components:

- A campaign targeting the general public and promoting a positive image of MFIs and their clients, and
- A campaign aimed at policy makers, promoting specific legislative changes.

Both components will aid the GMSE team in reaching its goal of developing a more positive regulatory and legislative environment for MFIs. However, the former is cross-cutting, effecting all the Tasks of the GMSE, and ultimately assisting in creating more sustainable and stable institutions through greater public awareness of MFI services.

The message of the MFI managers surveyed – that microfinance is a social good which develops the economy and benefits all Georgians – is a logical starting point for a public information campaign. The most critical targets of this message include the general public, the GNB and the Ministry of Finance. However, deeper attitudinal research into public perceptions of MFIs and the microtraders they serve must be conducted in order to develop a more targeted, and, therefore, more effective, message.

The second component of the public information campaign, targeting policy makers, will need to be based upon a detailed survey of the legislative environment in Georgia, as well as work by the proposed Policy Coordinating Body.

Additionally, there may be linkages between the public information task and the findings of Mr. Otaridze's research into the awareness and potential impact of the new flat tax (see Task 1). Could public and government perceptions of microtraders be improved if more traders pay the flat tax and exit the grey economy? Should an information campaign be initiated with the MFIs to increase awareness in the benefits of the flat tax?



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# Appendix A – Oxfam’s Draft MFI Law

*DRAFT*  
**18.06.02**

## **LAW OF GEORGIA ON MICRO-LENDING INSTITUTIONS**

### Chapter I.

#### General Provisions

##### ARTICLE 1. PURPOSE OF THE LAW

1. The purpose of this Law is the legal regulation of the relations pertaining to micro-lending institutions.
2. In the regulation of micro-lending institutions, this Law shall prevail over other legislative acts.

##### ARTICLE 2. A MICRO-LENDING INSTITUTION

1. A micro-lending institution is a non-banking, non-depository, non-entrepreneurial legal entity established in accordance with and for the purposes of this Law, which carries out micro-lending activities, provided for by this Law and other legislative acts of Georgia.
2. A micro-lending institution shall be required to meet the following conditions:
  - a) the maximum amount of current average principal outstanding balance per borrower shall not exceed three times the annual subsistence minimum established under the Georgian legislation;
  - b) the duration of micro-loans granted by a micro-lending institution shall not exceed 24 months.

##### ARTICLE 3. DEFINITION OF TERMS

For the purpose of this Law the terms of the Law shall have the following meaning:

- a) **Donor** means a person making a donation of assets or money to a micro-lending institution for the purpose of carrying out socially useful activities;
- b) **Micro-lending activity** means lending and other related activities provided for by Chapter 4 of this Law;
- c) **Micro-loan** means an obligation related to the granting of sums of money on condition that they are repaid on agreed dates and with an agreed rate of interest, and with observance of limitations provided for by this Law; a micro-lending institution is entitled to effect such granting without a licence issued by the National Bank of Georgia;
- d) **Individual micro-loan** is a type of loan granted by a micro-lending institution to one person and secured by pledge, mortgage, warranty or bank guarantee, or not secured.  
(*See Comment for Article 2.2*)
- e) **Group micro-loan** is a type of loan granted without material security to a group consisted of at least four physical persons united under the solidarity/joint liabilities;
- f) **Lending** means allocation of money for the purpose of honouring an approved proposal for borrowing in accordance with the terms and conditions provided for by a micro-loan agreement;
- g) **Terms and conditions of lending** means standard terms and conditions of an agreement forming an integral part of a micro-loan agreement;
- h) **Micro-loan agreement** means an agreement in writing under which a micro-lending institution grants, and a borrower receives, an individual or group micro-loan;
- i) **Loan resource** means funds granted as a loan;
- j) **Current average outstanding principle balance per borrower** means the ratio of a micro-lending institution's Gross outstanding loan portfolio to a total number of clients;
- k) **Risk** means the possibility of non-repayment of a micro-loan;
- l) **Administrative and business costs** means expenses provided for by the International Accounting Standards;
- m) **Insider** means a founder, donor, member of the Board or the Supervisory Council, special representative, senior executives, officers, or their relatives.
- n) **Relative** means the category of persons provided for by the Tax Code of Georgia.

#### Article 4. Purpose of a Micro-Lending Institution

1. A micro-lending institution shall seek to create and maintain employment for socially vulnerable segments of society, raise their income levels, reduce poverty and support the development of small business through financial and other services.
2. The purpose of a micro-lending institution shall not be profit-making. Revenues derived through micro-lending activities shall be solely used to achieve the purposes of a micro-lending institution.
3. Micro-lending activity carried out by a micro-lending institution is of socially useful nature and cannot be qualified as an entrepreneurial activity.

## Chapter II.

## Establishment of a Micro-lending Institution and Its Organisational Structure

### ARTICLE 5. ESTABLISHMENT OF A MICRO-LENDING INSTITUTION

A micro-lending institution shall be established in the organisational-legal capacity of foundation or branch of a foreign foundation registered with the Ministry of Justice of Georgia. It shall be established and registered in accordance with the relevant provisions of this Law and the provisions of the Civil Code of Georgia relating to funds.

### ARTICLE 6. NAME OF A MICRO-LENDING INSTITUTION

1. A micro-lending institution shall be required to use only the title provided for by its Statute (or the abbreviation provided for by its Statute).
2. A micro-lending institution shall be required to include the term “micro-lending institution” in its full title, or the abbreviation “MLI” in its short name.
3. A micro-lending institution shall not be authorised to use the terms “bank”, “state”, “national”, “central” or “insured” either in full or in part, in any language or in any combination.
4. In the event of any change in its title, a micro-lending institution shall, within a reasonable timeframe but not later than within one month, make a relevant statement.
5. The term micro-lending institution or the abbreviation “MLI” or any other word combination with this term can only be used in the legal name or for advertising purposes by such micro-lending institutions that carry out their activities under this Law.

### ARTICLE 7. GOVERNANCE AND MANAGEMENT OF A MICRO-LENDING INSTITUTION

1. Governance and management of a micro-lending institution shall be carried out in accordance with this Law and the Civil Code of Georgia.
2. Activities of a micro-lending institution shall be governed by the Board. In certain cases special representatives can be authorised to undertake the governance of the institution within their limits of competence provided for by the Statute.
3. For the purpose of appointing and relieving the Board and special representatives, and overseeing them, as well as for the purpose of discharging other functions entrusted to them by the Statute and the Civil Code of Georgia, the founders of a fund shall be required to establish the Supervisory Council.

### ARTICLE 8. REORGANISATION

1. Reorganisation of a micro-lending institution shall be carried out in accordance with the procedure provided for by the Civil Code of Georgia in respect of funds.
2. In the event of reorganisation, there shall be no damage incurred to the borrowers of a micro-lending institution, or other creditors.

3. There shall be no reduction in the amount of assets necessary for carrying out micro-lending activity.
4. At least one successor of a micro-lending institution shall maintain the purpose of the micro-lending institution. Reorganisation of a micro-lending institution in the form of merger or consolidation shall only be possible with an organisation having similar purposes.

#### ARTICLE 9. LIQUIDATION

1. Liquidation of micro-lending institution shall only be effected in accordance with the procedure provided for by the Civil Code of Georgia in respect of funds.
2. The Statute shall define persons having authority over the property in the event of liquidation.

### **Chapter III.**

#### Property of a Micro-lending Institution

#### ARTICLE 10. SOURCES OF PROPERTY

Property of a micro-lending institution shall be built up by the following sources:

- a) Founders' contribution (transferred property);
- b) Grants;
- c) Donations;
- d) Earnings derived through the use of property;
- e) Received loans;
- f) Earnings derived through activities provided for by this Law.

#### ARTICLE 11. RESTRICTIONS ON INVESTMENT ACTIVITY

1. A micro-lending institution shall be authorised to effect equity investments only through means that constitute not more than 20% of its property.
2. The amount of shares of a micro-lending institution in the shareholders equity of a single business legal entity shall not exceed 5%.
3. Investment activity affected in accordance with provisions of Para.1 and 2 of this Article does not represent entrepreneurial activity.

### **Chapter IV.**

Lending and Other Related Activities of a Micro-lending Institution, Administration of Micro-Loans, Relations with Borrowers

ARTICLE 12. ACTIVITIES OF A MICRO-LENDING INSTITUTION

Activities of a micro-lending institution shall include:

- a) Identification of potential donors;
- b) Social environment and market research and analysis;
- c) Implementation of training programmes for and provision of consulting services to borrowers;
- d) Granting of loans to borrowers (lending) on the basis of proposals for borrowing, and oversight of their execution;
- e) Investment activities effected in accordance with provisions of this Law;
- f) Other types of non- entrepreneurial activity provided for by the Georgian legislation.

ARTICLE 13. PRINCIPLES OF MICRO-LENDING INSTITUTION ACTIVITIES

1. A micro-lending institution shall carry out its activities on the basis of the following principles:
  - a) Commitment to the initial purpose/mission. The use of the assets of a micro-lending institution shall only be allowed to fulfil its purposes. The use of funds of a micro-lending institution for other purposes shall only be allowed in the event of a split-up of the entity. A change of the purpose shall be effected in accordance with the procedure provided for by the civil legislation;
  - b) Independent decision-making;
  - c) Openness and transparency of programme, financial and tax reporting;
  - d) Principles of micro-loan portfolio diversification policy shall be determined in accordance with the organizational charter, or in accordance with the lending policy approved by the founders of a micro-lending institution or its Supervisory Council.
2. In evaluating requests for loans, a micro-loan institution shall be guided by the principles of fairness, efficiency, sustainability and prudence.

ARTICLE 14. LIMITATIONS ON MICRO-LENDING ACTIVITY

In carrying out its micro-lending activity, a micro-lending institution shall not:

- a) receive contributions (of depository nature) or deposits without a relevant license;
- b) allocate a grant bypassing a procedure established by the Supervisory Council;
- c) borrow or impose any obligation on the institution's property without a proper decision made by the Supervisory Council and authenticated by a notary. The Statute of a micro-lending institution shall provide for the procedure of making such decisions.



- d) the maximum amount of current investment per one borrower shall not exceed three times the annual subsistence minimum established under the Georgian legislation. Calculation of a current average outstanding principle balance per borrower shall be based on a published annual subsistence minimum index for the most recent calendar year.
- e) Current average outstanding principle balance granted to insiders shall not exceed 5% of total current outstanding loan portfolio.
- f) the size of a loan granted to an employee of a micro-lending institution shall not exceed the remuneration payable in the period from the date of loan granting to the end of the term of the labour contract, and in the event of an open-end contract – payable in one year.

#### ARTICLE 15. SIZE OF A MICRO-LOAN, ITS PERIOD OF RETURN AND SECURITY

The size of a micro-loan, its period and procedure for repayment, as well as the issue of security for a loan shall be provided for by an agreement between a micro-lending institution and a borrower, this Law, terms and conditions of lending, and relevant legislative and normative acts of Georgia.

#### ARTICLE 16. REPAYMENTS IN ADVANCE (PREPAYMENTS)

A borrower shall be entitled to repay a loan any time before the maturity date of the loan, as stipulated in the loan agreement. The procedure of prepayments of a loan shall be provided for by the terms and conditions of lending, and a micro-loan agreement.

#### ARTICLE 17. INTEREST RATE AND SECURITY

- 1. A micro-lending institution, with the consent of a borrower, can determine:
  - a) the interest rate on a micro-loan based on the size of a micro-loan, its period, administrative and business costs, borrowers credit history, and the risk. The interest rate on a micro-loan shall reasonably comply with the market rate of interest.
  - b) the instrument of security, in accordance with the relevant legislative and normative acts.

#### ARTICLE 18. MICRO-LOAN AGREEMENT

- 1. Relations between a borrower and a micro-lending institution shall be regulated by the relevant micro-loan agreement made in writing in accordance with the terms and conditions of lending, provisions of this Law, other relevant legislative and normative acts.
- 2. Any amendments or additions to the micro-loan agreement on the part of a micro-lending institution or a borrower shall only be made by mutual consent of the parties. A

micro-lending institution shall not have the right to change unilaterally the terms and conditions of a concluded micro-loan agreement, unless otherwise provided for in the agreement.

3. Any dispute or difference between a micro-lending institution and a borrower that may arise out of or in relation to the loan agreement shall be resolved through negotiations between the parties. If the Parties have failed to resolve the dispute, such disputes and differences shall be referred to and settled by arbitration, on agreement between the parties, or by a court.

#### ARTICLE 19. TERMS AND CONDITIONS OF LENDING

1. Before the execution of a micro-loan agreement, and also for all interested parties, a micro-lending institution shall make available the information on its activities, as well as all its conditions and terms of lending.
2. The terms and conditions of lending shall be approved by the Supervisory Council on the basis of the principles of micro-lending institution activities.
3. Terms and conditions of lending shall envisage developing of a borrower's entrepreneurial skills.

#### ARTICLE 20. AVOIDANCE OF THE CONFLICT OF INTERESTS

Any member of management or employee of a micro-lending institution:

- a) shall in his/her line of duty be guided by the interests of the micro-lending institution and not by personal interests, serve the purposes of the micro-lending institution, take care of its assets and property, and make reasonable and purpose-oriented decisions;
- b) can be member of the Board, special representative or officer of only one micro-lending institution operating in Georgia. This limitation shall not apply to members of the Supervisory Council;
- c) shall not hold a management or any other position in government bodies, including local government or self-governance bodies;
- d) shall not be involved in a decision-making process regarding the granting of a loan to him/her or any related person, as defined by the Tax Code of Georgia.

#### ARTICLE 21. LIMITATION ON ADDITIONAL DEBT LIABILITY

A borrower shall be required to obtain consent of a contractor micro-lending institution before assuming any additional material responsibility.

#### ARTICLE 22. CONFIDENTIAL INFORMATION

1. A micro-lending institution, its founders, members of the Board and the Supervisory Council, executive officers, employees and agents shall be prohibited from using for other purposes or communicating to the third parties any information that has been provided to them, or that is accessible for them, as a result of relations between a micro-lending institution and potential, current or former borrowers without the consent of the parties concerned. This prohibition shall apply to all physical and legal persons to whom a micro-lending institution provides respective services, irrespective of whether or not they hold micro-loans of the micro-lending institution.
2. Prohibitions and limitations stipulated in Para.1 shall not apply, if a person receiving information is obliged to disclose that information in accordance with the procedure provided for by the law.
3. Where one micro-lending institution shares with another micro-lending institution its evaluation of the credit history of borrower, this shall not be considered to be confidential information. A micro-lending institution evaluates a borrower's credit history by a three-grade rating system and gives it grades: 1,2 or 3.  
Grade 1 means a reliable and disciplined borrower;  
Grade 2 means a less reliable and disciplined borrower;  
Grade 3 means an unreliable borrower.

## **Chapter V.**

### Supervision over the Execution of Loans and the System of Evaluation

#### *Article 23. Supervision over the Execution of Loans Granted by a Micro-lending Institution*

1. A micro-lending institution shall be authorised to carry out supervision over activities implemented with the granted loan, in accordance with the terms and conditions of lending and the loan agreement. The purpose of supervision is to establish to what extent the borrower's activities comply with the proposal for borrowing approved by a micro-lending institution.
2. In the event of material difference between the proposal for borrowing and the actual activity of the borrower, the latter shall be required to explain the reasons for a departure from the submitted proposal.
3. In the event of eliciting a material difference between the proposal on borrowing and the borrower's activity that increases the default risk, the micro-lending institution shall have the right to apply sanctions provided for by the loan agreement, including: suspending next disbursement, demanding that the borrower, within the shortest time possible, revert to the activity specified in the proposal for borrowing, or demanding advanced return of the loan.

#### ARTICLE 24. MONITORING AND EVALUATION OF ACTIVITIES OF A MICRO-LENDING INSTITUTION

1. Monitoring and evaluation of the activities of a micro-lending institution shall be carried out by:
  - a) Founders, as provided for by the Statute;
  - b) Donors, within the framework of the agreement;
  - c) The Ministry of Justice, in accordance with the effective legislation.
2. Evaluation of a micro-lending institution's performance shall be based on the following criteria:
  - a) Total number of active borrowers;
  - b) Number of persons having sustainable employment within programmes and schemes implemented with loans granted by the institution;
  - c) Share of borrowers with positive credit history in the total number of borrowers;
  - d) Number of successful projects implemented with loans granted by the institution;
  - e) Financial soundness of the institution.
3. The number of borrowers that succeeded in obtaining bank credits is an additional indicator to evaluate performance of a micro-lending institution.

Chapter VI.

Regulation, Control and Regulatory Authority

ARTICLE 25. REGULATION

A micro-lending institution is a self-regulated organisation. No one shall have the right to interfere in the decision-making process of a micro-lending institution related to its activity.

ARTICLE 26. FINANCIAL AND TAX REPORTING

1. A micro-lending institution is financially accountable to its founders, donors and the Supervisory Council.
2. A micro-lending institution shall conduct an external independent audit once on an annual basis, with the results of an audit being subject to mandatory promulgation..
3. The Supervisory Council shall exercise current control, and before the 25<sup>th</sup> day of the month following the end of each quarter shall assess the performance of the micro-lending institution over the period of the past quarter.
4. The forms of financial reporting shall be determined under the Law of Georgia "On Accounting", whereas the forms of tax reporting shall be determined under the Tax Code of Georgia.

ARTICLE 27. CONTROL

1. State control over the activities of a micro-lending institution shall be exercised by the Ministry of Justice in accordance with the Civil Code of Georgia.

2. Control over the activities of a micro-lending institution and efficient and purpose-oriented spending of funds shall be exercised by the founder over the full amount of funds, in accordance with the procedure provided for by the Statute, and by the donor – over the assets and property granted by the latter, in accordance with the procedure provided for by the relevant agreement.
3. Internal control of a micro-lending institution shall be exercised in accordance with the Statute (by the Supervisory Council and external audit).

## **Chapter VII.**

### **Transitional and Closing Provisions**

#### **ARTICLE 28. MEASURES RELATED TO EFFECTING THIS LAW**

1. Within four months after the effective date of this Law all persons engaged in micro-lending activities shall be required to bring their organisational-legal capacity in conformity with the provisions of this Law.
2. Persons engaged in the activities described in this Law and registered by the Ministry of Justice in the organisational-legal capacity of a fund , shall be required to bring their Statutes in conformity with the provisions of this Law.

#### **ARTICLE 29. EFFECTING THE LAW**

This Law shall come into force from XXXX.

President of Georgia

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**This Draft has been prepared by the network of MF practitioners operating in Georgia—World vision; FINKA international; CONSTANTA foundation; OXFAM Georgia---with an active support of OXFAM GB.**

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# Appendix B -- Analysis of Draft Law

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This draft law attempts to clarify the legitimacy of non-profit microlending institutions. In doing so, it narrowly defines how non-bank MFIs (NBMFIs) may operate, restricting operations, curtailing potential innovations, and entailing burdensome operational changes. However, it should also be noted that much of the language in the draft is unwieldy and unclear, opening the door to further confusion and conflicts with tax and other regulatory authorities. This vague language is actually more worrisome than the problems listed below.

- Article 2.1 states that NBMFIs are non-depository. A more elegant solution would be to introduce a tiered regulatory system, which would enable regulated MFIs to mobilize deposits.
- Articles 2.2 and 2.3 limit the size and duration of loans. With more non-bank MFIs diversifying into larger loan sizes this is restrictive. Also, it would restrict innovations in long-term lending (e.g. mortgage lending). It should be noted that the ProCredit Bank (which is for-profit) defines microloans as between 50 – 50,000 USD.
- Article 3, section e defines microloan groups as having at least 4 people in them. FINCA Georgia has successful solidarity groups with three borrowers in them. Defining the number of group members is, again, overly restrictive and unnecessary.
- Article 4 attempts to rationalize the non-profit nature of NBMFIs. In doing so, it states that their activities are “socially useful” and, therefore, not “entrepreneurial.” However, “socially useful” and “entrepreneurial” are not and should not be mutually exclusive. Microlending *is* an entrepreneurial activity, and that should be recognized and permitted. What Georgian law really needs is a cleaner definition of a non-profit, which enables non-profits to engage in economic activities as long as the profits remain within the organization.
- Article 4 also limits an NBMFIs to activities which increase employment and develop businesses. This could preclude housing loans or other consumer products from becoming a part of the NBMFI’s portfolio.
- Article 5 states NBMFIs are to be registered as foundations. Many NBMFIs are successfully (and legally) operating as unions. This regulation would require them to re-register.
- Article 5.8 states that reorganization of NBMFIs “in the form of merger or consolidation shall only be possible with an organisation having similar purposes.” This would prevent NBMFIs from merging with or having their portfolio purchased by a commercial entity

(e.g. a bank). NBMFIs should have the right to transform or merge into commercial entities. Under current Georgian law, rules regarding the re-organization of a union or foundation may be defined in the organization's charter. The current law is workable and should not be changed.

- Article 6.1 requires NBMFIs to include the term “micro lending institution” in their name. This is unnecessary.
- Article 10e states that NBMFIs may receive loans. It doesn't enable NBMFIs to receive credit from a commercial bank, however (please see discussion on “credit” vs. “loans” under the “Legislative Concerns” section on page 5).
- Article 11.2 states that NBMFIs may not hold more than 5% of shares in another organization. This would preclude an NBMFI from developing, for example, a separate leasing company.
- Article 12 states that NBMFIs must conduct social environment and market research. This could enable a zealous tax authority to demand yearly proof of such, which is unnecessarily burdensome.
- Article 14d once again limits loan sizes, and is unnecessary.
- Article 14e limits loans to insiders to 5% of the current outstanding portfolio, giving the green light to insider lending. Article 14f defines loan sizes for employees of the NBMFI. These are both activities that should be dictated by CGAP “Best Practices” rules, not by this draft law.
- Article 16 defines the rules for client pre-payments. This should be defined in individual loan contracts, not regulated by a separate law on NBMFIs.
- Article 19.1 states that NBMFIs must make information on its activities and terms of lending available to all interested parties. This is just one example of the vague language found throughout this draft law. To whom must this information be made available? What sort of information must be made available? What happens if it is not made available?
- Article 19.3 states that “terms and conditions of lending shall envisage the development [sic] of a borrower's entrepreneurial skills.” How does an MFI measure this? What happens if a tax auditor determines the NBMFI has failed in this area? This regulation could also preclude any sort of consumer or housing loans.
- Article 20 defines conflict of interests and admonishes NBMFI managers to serve the best interests of the organization. This is unnecessary. Georgian law already defines illegal activities and conflicts of interest.
- Article 22.3 defines how NBMFIs must rate their clients' credit histories, in spite of the fact that there is no existing platform for sharing credit ratings. Should a credit rating agency be developed (and one is planned), the agency will no doubt define how credit

ratings are input into it, and these requirements will likely differ from the ratings defined in this draft law.

- Article 24 defines how the Ministry of Justice shall evaluate NBMFIs. At present, the Ministry of Justice does not have the resources for such an evaluation. And if the Ministry somehow found the NBMFI lacking, what would be its next step? Further, some of the criteria listed are difficult to measure, e.g. the number of persons with sustainable employment. What, exactly, is “sustainable employment?”
- Article 25 states that an NBMFI is self-regulated and no organization has the right to interfere with it. Article 27 says the NBMFI is regulated by the Ministry of Justice. This appears contradictory.
- Article 26 states that the NBMFI “is financially accountable to its founders, donors and the Supervisory Council.” This should be self-evident, and does not need to be enshrined in law.

There is a Catch-22 when any law defining NBMFI operations is drafted. A law narrowly defining operations will also narrowly define NBMFIs, and diversification and innovations will be restricted. However, a more open law will invite more of the regulatory and tax ambiguities which NBMFIs are currently struggling under. This draft law, however, both restricts NBMFI operations through its narrow definitions and creates regulatory confusion due to its vague and awkward language.



# Appendix C – MicroFinance

## Industry SWOT Analysis

	Credit Unions	Non-bank MFIs (Unions & Foundations)	Commercial Banks
Strengths	<ul style="list-style-type: none"> <li>Ability to function in remote areas with little infrastructure.</li> </ul>	<ul style="list-style-type: none"> <li>High repayment rates;</li> <li>Low (or no) collateral requirements for group loans;</li> <li>More “comfortable” to borrowers than banks, especially in regions outside Tbilisi.</li> </ul>	<ul style="list-style-type: none"> <li>Efficiency of operations;</li> <li>Low cost of credit products;</li> <li>Funding available for lending;</li> <li>Existing infrastructure of facilities, etc.</li> </ul>
Weaknesses	<ul style="list-style-type: none"> <li>Poor internal controls/management have led to multiple credit union failures.</li> </ul>	<ul style="list-style-type: none"> <li>Inefficiency of operations;</li> <li>Most unions and foundations need additional loan cap funding.</li> <li>High cost of loan products.</li> </ul>	<ul style="list-style-type: none"> <li>Low degree of trust in Georgian banks, especially in the regions.</li> </ul>
Opportunities	<ul style="list-style-type: none"> <li>New licensing of credit unions by GNB may improve operations;</li> <li>Increased funding from World Bank.</li> </ul>	<ul style="list-style-type: none"> <li>Opportunity to partner with banks and expand outreach;</li> <li>Potential regulation by GNB may force MFIs to best practices.</li> </ul>	<ul style="list-style-type: none"> <li>Expansion of microcredit to existing offices throughout Georgia;</li> <li>Opportunity to partner with non-bank MFIs and expand outreach.</li> </ul>
Threats	<ul style="list-style-type: none"> <li>New licensing requirement by GNB may put more credit unions out of business.</li> </ul>	<ul style="list-style-type: none"> <li>Poor legal environment destabilizes operations and reduces risk tolerance;</li> <li>Potential regulation by GNB could be disastrous if it is not geared towards the realities of non-bank MFI operations.</li> <li>Banks expanding into the micro-market will erode client base for individual loans over \$500.</li> </ul>	<ul style="list-style-type: none"> <li>Banking system still unstable and banks will continue to fall.</li> </ul>